

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

No. 7942 of 2008

**IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL
(EUROPE) (IN ADMINISTRATION)
AND IN THE MATTER OF THE INSOLVENCY ACT 1986**

B E T W E E N

- (1) ANTONY VICTOR LOMAS**
- (2) STEVEN ANTHONY PEARSON**
- (3) PAUL DAVID COPLEY**
- (4) RUSSELL DOWNS**
- (5) JULIAN GUY PARR**

**(THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS
INTERNATIONAL (EUROPE) (IN ADMINISTRATION))**

Applicants

- and -

- (1) BURLINGTON LOAN MANAGEMENT LIMITED**
- (2) CVI GVF (LUX) MASTER S.A.R.L.**
- (3) HUTCHINSON INVESTORS, LLC**
- (4) WENTWORTH SONS SUB-DEBT S.A.R.L.**
- (5) YORK GLOBAL FINANCE BDH, LLC**
- (6) GOLDMAN SACHS INTERNATIONAL**

Respondents

SUPPLEMENTAL ISSUE 2
SENIOR CREDITOR GROUP'S REPLY SUBMISSIONS

A. INTRODUCTION

1. Supplemental Issue 2 asks:

“Whether and (if so) in what circumstances and in what manner a Currency Conversion Claim can arise from the discharge of a debt by way of set-off pursuant to Rule 2.85(3)”

2. The factual circumstances in which Supplemental Issue 2 arises can be illustrated by the following example:

- (1) Creditor A is owed \$1000 by LBIE.
- (2) LBIE has a cross-claim against A for £2.
- (3) At the time of commencement of LBIE’s administration, the applicable exchange rate was \$1:£1.
- (4) Upon LBIE giving notice to make a distribution under Rule 2.95, LBIE’s cross claim against Creditor A is set off against Creditor A’s claim against LBIE pursuant to Rule 2.85.
- (5) At the time that the notice to make a distribution is given, sterling has depreciated against the dollar and the applicable exchange rate is \$1:£2. However, set-off occurs pursuant to Rule 2.85 by reference to the applicable exchange rate of \$1:£1 at the commencement of the administration, such that \$2 of Creditor A’s claim is discharged by set-off.
- (6) Creditor A submits a proof for the unpaid balance of its claim of \$998 converted into sterling.

3. Supplemental Issue 2 is concerned with whether a Currency Conversion Claim may exist in respect of the \$2 of Creditor A’s claim that was set off, in circumstances where LBIE’s cross-claim for £2, which was used to pay and discharge that \$2, was only worth \$1 at the time of set-off.

B. BACKGROUND TO ISSUE 2

4. If a creditor with a claim denominated in a foreign currency does not receive through the proof process dividends which fully satisfy its underlying foreign currency denominated rights, he has non-provable claim for the shortfall (see the Court of Appeal decision in *Waterfall I* [2015] 3 WLR 1205)¹.
5. It is therefore uncontroversial that set-off does not remove a foreign currency creditor's underlying entitlement to be paid the net balance of his claim in a foreign currency. Specifically:
 - (1) Set off in an administration is governed by Rule 2.85. Rule 2.85(6) provides that “*Rules 2.86 to 2.88 shall apply for the purposes of this Rule in relation to any sums due to the company which – (a) are payable in a currency other than sterling*” (emphasis added).
 - (2) Thus, for the purposes of the set-off required by Rule 2.85, foreign currency claims are converted into sterling at the exchange rate applicable as at the date of the administration and the relevant claim and cross-claim are set off. Save insofar as necessary to effect the set-off, the creditor's rights are unaffected.
 - (3) This is reflected in the judgment of Moore-Bick LJ in the Court of Appeal in *Waterfall I* *ibid.* at [250], where he stated (emphasis added):

“Such a set-off operates by reference to the value of the claim and cross-claim at the date of the winding up order and is effective to discharge the company's debt pro tanto. As a result the foreign creditor obtains full value for his debt at the time of payment, albeit through the mechanism of conversion into sterling (as indeed he would if he were to execute on assets held in this country). It does not follow that the outstanding portion of the obligation should cease to be denominated in the relevant foreign currency”

¹ Although Supplemental Issue 2 asks “*in what manner a Currency Conversion Claim can arise*”, a Currency Conversion Claim simply reflects the unpaid balance of a claim denominated in a foreign currency which has not been paid and discharged by the proof process.

6. In this regard, the analysis regarding the balance of a foreign currency debt which is partially paid by way of set-off is similar to that which applies in respect of a future debt or an interest bearing debt owing to the company:

- (1) In *Re Kaupthing Singer & Friedlander Ltd* [2010] Bus LR 1500 the Court of Appeal held that, while Rule 2.85(7) requires all future claims to be discounted in accordance with Rule 2.105 before being set off, that does not have the effect of changing the parties' substantive rights in respect of any unpaid balance over and above the amount required for the purposes of the set-off. As Etherton LJ stated:

"I see no difficulty in the circumstances in reading the words "for the purposes of this rule" in IR 2.85 as confining the effect of the incorporation of IR 2.105 to what is necessary to calculate what should be paid by way of dividend to the creditor, and, for that purpose, the making of insolvency set-off, and as not touching at all upon what remains due to the company after the insolvency set-off has taken place" (at [34]).

- (2) Likewise, at first instance, in *Re Kaupthing Singer & Friedlander Ltd* [2009] EWHC 2308 (in part of the decision that was not appealed), Norris J considered the interest accruing on the net balance in the following terms:

*"The balance is not a newly created liability, the novel product of a statutory process. It is the balance due under a contract, the remainder of which has been extinguished in the insolvency set-off. Indeed it is quite plain that "the balance" continues to be subject to the terms of the contract under which it arises, for in the case of a contingent or prospective debt the rule goes on to say that such a balance "shall be paid if and when that debt becomes due and payable" (i.e. under the contract, on the loan maturity date or earlier under any default provisions)."*²

- (3) There is no sensible policy reason why insolvency set-off should have the effect of depriving a creditor of a Currency Conversion Claim that it

² As identified by Norris J in *Re Kaupthing Singer & Friedlander Ltd*, the fact that the unpaid balance remaining after insolvency set-off continues to be subject to the terms of the contract under which it arises (including a right to be paid in a foreign currency) is further illustrated by the terms Rule 2.85(8). Thus, in the case of any part of the balance in favour of the company which results from a contingent or prospective debt owed to the company, Rule 2.85(8) provides *"the balance (or that part of it which results from the contingent or prospective debt) shall be paid if and when that debt becomes due and payable"*.

would otherwise have had in respect of the unpaid balance of its claim, any more than it should affect the unpaid balance of a future claim; see, by analogy, Etherton LJ in *Re Kaupthing* at [32].

7. The principles set out above are wholly compatible with the decision in *Stein v Blake* [1996] AC 243 (which decision was expressly considered and put into appropriate context by the Court of Appeal in both *Waterfall I* and in the *Kaupthing* decision referred to above).

C. ISSUE 2

8. The substantive issue which Supplemental Issue 2 does raise is the separate and discrete issue as to whether a Currency Conversion Claim can arise in respect of that part of a debt which is discharged by way of set-off in an administration pursuant to Rule 2.85(3).

9. In circumstances where the issues are being addressed in substance and in detail by the other parties, the Senior Creditor Group does not consider that it would be of assistance to make detailed submissions in writing and at this stage simply makes the following limited observations:

- (1) The Senior Creditor Group understands the argument in favour of a Currency Conversion Claim existing as a result of the discharge of a debt by way of set-off pursuant to Rule 2.85(3) as follows. The existence of such a claim is argued to be a consequence of the fact that, in an administration, although set-off is expressed to take effect as at the date of notice of proposed distribution, it takes effect by reference to the sterling-equivalent of the foreign currency debt valued as at the earlier Date of Administration. Reverting to the example given above, the logic of the argument is that a Currency Conversion Claim of \$1 may arise.

- (2) However, York seeks to push that logic further and contend that a Currency Conversion Claim arises even in circumstances where the balance of account between the parties is \$100 each way. Such a submission is surprising and, in the Senior Creditor Group's view,

incorrect as it cannot sensibly reflect the intended legal effect of insolvency set-off pursuant to the Rules where there are equal and opposite claims existing in the same currency.

- (3) The Senior Creditor Group can see how York's general position may give rise to greater complications in multi-currency cases, as identified in the Administrators' and Wentworth's Supplemental Submissions. However, it is unclear to what extent there are multi-currency or other issues arising in relation to the administration of LBIE. As Briggs LJ observed in the Court of Appeal in *Waterfall I* at [159] – [160], given the variety of circumstances in which such issues may arise, these are precisely the type of issues that should be resolved on a case by case basis by the Courts if and when such cases arise and that would be the appropriate forum in which to deal with such scenarios, if indeed they exist.
- (4) The strictly logical position may give rise to a difference between the effects of set-off in an administration and its effects in a liquidation. However, this arises because all liquidations are (in principle at least) distributing, such that the rules of insolvency set-off are immediately applicable. By contrast, not all administrations are distributing, such that the rules of insolvency set-off are not applied unless and until a notice of intention to distribute is given under Rule 2.95 and the account is expressed to be taken as at that date.
- (5) Whether or not the effects of set-off in an administration and in a liquidation are different and, in particular, whether set-off in an administration can give rise to a Currency Conversion Claim, may therefore depend on how the court construes the operation of administration set-off under the rules. In particular, it may depend on whether the court concludes that, under the rules: (a) set-off in an administration operates as at the date of administration, albeit that the obligation to take an account is only triggered at the date of the notice under Rule 2.95; or (b) concludes that, under the rules, set-off in an administration only operates as at the date of the notice under Rule 2.95. In this respect the Senior Creditor Group notes that the net claim of a

creditor following a balance of account and set-off attracts statutory interest under Rule 2.88 from the date of administration, not the date of the Rule 2.95 notice.

ROBIN DICKER QC

RICHARD FISHER

HENRY PHILLIPS

South Square

20 January 2015

Gray's Inn

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WATERFALL II DIRECTIONS APPLICATION

SENIOR CREDITOR GROUP'S SKELETON
ARGUMENT
FOR TRIAL (PART C)

Freshfields Bruckhaus Deringer LLP

65 Fleet Street, London, EC4Y 1HS

Tel: 0207 9364000

Solicitors for CVI GVF (Lux) Master S.a r.l.

Ropes & Gray International LLP

60 Ludgate Hill, London, EC4M 7AW

Tel: 0203 2011500

Solicitors for Hutchinson Investors, LLC

Morrison Foerster

City Point, One Ropemaker Street London, EC2Y 9AW

Tel: 0207 79204000

Solicitors for Burlington Loan Management Limited